



An insurer's pre-contractual duty of disclosure under the Marine Insurance Act 1909 (Cth)

Kate Lewins*

The Marine Insurance Act provides that both parties to the contract owe each other a duty of utmost good faith. While it has been accepted by the courts that the duty is two way, the scope of the duty falling on the insurer remains undefined. This article explores why this is so, and concludes that the lack of an attractive remedy is the cause. It is necessary to reform the law to provide such a remedy, in order to correct the current 'one way street'.

Introduction

[Consider] the situation if an insurer were to become aware . . . before the commencement of an insurance contract, that the broker had breached its professional duty toward the insured by failing to obtain a vital element of coverage and the insured was unaware of this. Utmost good faith might well require the insurer to inform the insured of its brokers' dereliction . . .

This quote gives a clear example of the scenario the subject of this article, as posited by the respected insurance commentator Fred Hawke.¹

It is technically correct to say that an insurer writing marine insurance in Australia owes a pre-contractual duty of disclosure to its potential insured as part of its duty of utmost good faith. While the insurer may well owe such a duty, the insured faces difficulties in enforcing it. First, a dearth of cases means that the scope of the duty has not been sufficiently fleshed out as yet. The reason for that is a direct result of the second difficulty, which is the lack of an effective remedy for an insured claiming a breach of utmost good faith in a marine insurance contract. The remedy available to an insured, at least in marine insurance, is avoidance of the contract. This 'wholly one-sided'² remedy is unattractive to an insured seeking to enforce, not escape, from the contract. This acts as a disincentive to pursue such claims against insurers.

While reforms contained in the Insurance Contracts Act 1984 (Cth) appear to have improved this aspect of the law for general insurance,³ the law of marine insurance⁴ is still bogged in the quagmire of the common law.

* Associate Professor, School of Law, Murdoch University. I thank Professor Rob Merkin for commenting on a draft of this paper insofar as it relates to the UK law and status of reforms; all errors remain mine.

1 'Utmost good faith — what does it really mean?' (1994) 6 *ILJ* 91 at text accompanying n 55.

2 *Manifest Shipping v Uni-Polaris Insurance Co (The Star Sea)* [2003] 1 AC 469 at 497 per Lord Hobhouse; [2001] 1 All ER 743; [2001] 2 WLR 170; [2001] 1 Lloyd's Rep 389.

3 The prevarication is deliberate. There is still at least an argument that s 13 will not provide a right to damages for pre-contractual disclosure: see n 60.

4 And other insurances not covered by the ICA: see s 8–9 of the ICA.

Marine insurance — the legislative regime in Australia

Australian marine insurance is governed by the Marine Insurance Act 1909 (Cth) (the MIA), a mirror of the original Chalmers Act of England, Marine Insurance Act 1906 (UK). The object of the Act was described by Chalmers himself as:

to reproduce as exactly as possible the existing law, without making any attempt to amend it.⁵

The MIA is regarded as a ‘partial codification of the common law’.⁶ It is regularly cited in non-marine cases as summarising the law relating to general insurance.⁷

By contrast, the regime governing general insurance in Australia altered significantly with the enactment of the Insurance Contracts Act 1984 (Cth) (the ICA). As readers will be aware, when introduced, the ICA represented a sweeping reform of insurance principles unlike anything in the common law world.⁸ While being interested in protecting consumers, that was never its primary aim. It sought to strike a fair balance between the interests of the insured and insurer.⁹

The ICA does not apply to those contracts to which the MIA applies.¹⁰ The enactment of the ICA created a schism that continues to exist between the regimes that cover general insurance and those that apply to marine insurance. There are, in effect, two main codes governing insurance law in Australia.¹¹ Because of the difference in outcome caused by application of the two contrasting legislative regimes, cases seeking to find the boundary between the two may be hard fought.¹²

The MIA has remained virtually untouched since its enactment over a

5 Chalmers, introduction to first edition of Digest, E R Hardy Ivamy Chalmers, *Marine Insurance Act 1906*, 9th ed, Butterworths, 1983.

6 *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995] 1 AC 501; [1994] 3 All ER 581; [1994] 3 WLR 677 at 683; [1994] 2 Lloyd’s Rep 427 (HL) (*Pan Atlantic*); as cited by M Kirby, ‘Marine insurance — is the doctrine of “Utmost Good Faith” out of date?’, 35th CMI Conference, at n 17.

7 See Law Commission & Scottish Law Commission, *Damages for late payment and the insurer’s duty of good faith*, Issues Paper 6, p 30 n 7, citing Lord Mustill in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd*: ‘the common law relating to the two types of insurance is the same, and that the Act embodies a partial codification of the common law’: [1995] 1 AC 501 at 518; [1994] 3 All ER 581; [1994] 3 WLR 677; [1994] 2 Lloyd’s Rep 427.

8 ALRC Report 91, *Review of the Marine Insurance Act 1909* (April 2009), at [3.10].

9 Terms of reference, *Insurance Contracts*, ALRC Report 20, p xv as cited in M Kirby, ‘Australian insurance contract law: Out of the chaos — a modern, just and reforming statute’ (2011) 22 *ILJ* 1 at 22.

10 Section 9 of the ICA.

11 R Merkin, ‘Australia: Still a Nation of Chalmers?’, Richard Cooper Memorial Lecture, sponsored by the University of Queensland and delivered at the Federal Court of Brisbane, 13 October 2011, at text accompanying n 21.

12 Eg, *Gibbs v Mercantile Mutual Insurance (Aust) Ltd* (2003) 214 CLR 604; 199 ALR 497; [2003] HCA 39; BC200304263; see K Lewins, ‘Where is the boundary between marine insurance and general insurance? *Gibbs v MMI* reaches the High Court’ (2003) 15 *ILJ* 1.

century ago.¹³ However this is perhaps not the vote of confidence in the MIA that one might at first assume. Indeed, the Australian Law Reform Commission (ALRC) received a reference from the Attorney-General to review the MIA in 2000. The ALRC produced a discussion paper¹⁴ followed by its report entitled 'Review of the Marine Insurance Act 1909' (ALRC Report 91).¹⁵ The reforms proposed by the ALRC were modest in some respects, having given significant weight to the importance of comity with the English law.¹⁶ Those reforms proposed included:

- Alteration of the coverage of the MIA so that it covered primarily commercial risks.
- Rewriting of remedies to bring them into line with modern expectations of fairness.
- The abolishing of warranties (including statutory warranties), to be replaced by express terms.
- The removal of the requirement of insurable interest, requiring instead a pecuniary or economic loss (again, taking a leaf from the ICA).

Even these proposals have, however, withered on the vine.

More recently, talk of reform to the MIA has been revived by the proposal by Professor Merkin, who suggests that perhaps Australia should stop being a 'nation of Chalmers' and abolish the MIA altogether.¹⁷ His proposal is that the ICA could easily be used to cover marine insurance law, albeit with the occasional modification.¹⁸ He points out that the proposals to reform insurance law in the United Kingdom do not distinguish between general and marine insurance.¹⁹ As Professor Merkin says, this leads to an ironic situation — that the proposed UK reforms to their insurance law²⁰ would mean that Australia may still be operating under an MIA with echoes of a bygone era, long after the parent Act in the United Kingdom has been transformed.²¹

13 Australia has removed the insurance of pleasurecraft from the reach of the MIA and into the coverage of the ICA: s 9A ICA inserted by Insurance Law Amendment Act 1998 (Cth); see ALRC report, p 33 at n 5. Sections 59–60, concerning payment of premium via a broker, were repealed in 2001: Financial Services Reform (Consequential Provisions) Act 2001 (Cth).

14 ALRC DP 63, July 2000.

15 Report 91, April 2001.

16 Report 91, at 1.14. See also Merkin, above n 11, at text accompanying n 19.

17 Which was considered and rejected by the ALRC in Ch 3 of their report, saying that it had 'no support' from the industry; see [3.20]. A decade later, the author agrees with Professor Merkin that the idea is worth revisiting.

18 See Merkin, above n 11.

19 Ibid, at text accompanying n 17.

20 See Law Commission website for comprehensive reports as to every stage of the reform process, at <<http://www.justice.gov.uk/lawcommission/areas/insurance-contract-law.htm>>.

21 Merkin, above n 11, conclusion.

Marine insurance and pre-contractual duties in Australia

The doctrine of utmost good faith — a two way duty

Insurance is an arrangement where much is taken on trust. The insurer does not have the time to investigate every last aspect of the risk it is being asked to insure, and must rely on the insured to provide accurate and extensive detail as to the risk. The insured gets the benefit of a quick decision on the basis that the insurer is relying upon information provided. While mutual dependency is a common feature of contracts, it is a unique feature of insurance law that these contracts are predicated on utmost good faith of both parties.²² The duty to act in utmost good faith exists not only once the contract is entered, but also prior to entry of the contract — significantly, during negotiations for cover.

The obvious manifestation of this pre-contractual duty is that it is incumbent upon the insured to disclose material facts to the insurer.²³ For many years the emphasis was entirely on the insured's pre-contractual duty of disclosure. Statutes tend to specifically outline the nature of the insured's duty of disclosure. There is no doubt, however, that the duty of utmost good faith generally and pre-contractual duty of disclosure in particular, was and is a two-way duty. That was made clear by the classic statement by Lord Mansfield in *Carter v Boehm* in 1766:

Insurance is a contract upon speculation. The special facts, upon which the contingent chance is to be computed, lie most commonly in the knowledge of the insured only: the under-writer trusts to his representation, and proceeds upon confidence that he does not keep back any circumstance in his knowledge, to mislead the under-writer into a belief that the circumstance does not exist, and to induce him to estimate the *risqué*, as if it did not exist.

The keeping back such circumstance is a fraud, and therefore the policy is void. Although the suppression should happen through mistake, without any fraudulent intention; yet still the under-writer is deceived, and the policy is void; because the *risqué* run is really different from the *risqué* understood and intended to be run, at the time of the agreement.

The policy would equally be void, against the underwriter, if he concealed; as, if he insured a ship on her voyage, which he privately knew to be arrived: and an action would lie to recover the premium . . .

Good faith forbids either party by concealing what he privately knows, to draw the other into a bargain, from his ignorance of that fact, and his believing the contrary. But either party may be innocently silent, as to grounds open to both, to exercise their judgment on.²⁴

The MIA restates this:

Section 23. A contract of marine insurance is a contract based upon the utmost good faith, and, if the utmost good faith be not observed *by either party*, the contract *may be avoided by the other party*.(emphasis added)

²² ALRC Report 91, at 10.1.

²³ The test of this is contained in s 24 of the MIA.

²⁴ (1799) 3 Burr 1905 at 1909; (1766) 97 Eng Rep 1162 at 1164 (emphasis added).

Defining the insurer's duty to disclose?

There is no question that under the current law as set out in the MIA (and also at common law) the insurer does owe the insured a pre-contractual duty as well as post contractual duties.²⁵ While the duty begins during negotiations and subsists through the entry and performance of the contract, the practical impact is different either side of entry of the contract. Once the contract is entered, the duty of the insurer manifests primarily in the manner of handling claims. This article says no more about that, being concerned with the duty prior to entry of the contract. At the pre-contractual stage, the duty of utmost good faith manifests primarily as a duty on both parties to disclose what might loosely be described as the facts pertinent to the other party's choice as to whether to enter insurance bargain, on what terms and for what premium.²⁶

Materiality in pre-contractual non-disclosure is a fraught area, with Australia and England developing different interpretations of the requirement at common law. In England the exact nature of what constitutes a material fact requiring disclosure in marine insurance was reworked by the House of Lords in 1994 in *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd*.²⁷ The House of Lords rejected the requirement that to be material, the fact must be a 'decisive' influence on the prudent insurer. However, as the ALRC has noted, the judgments do not make the precise test of materiality clear. Arnould's summary of the test of materiality in *Pan Atlantic* is 'whether the matter would have been taken into account by the hypothetical prudent insurer when assessing the risk'.²⁸ The significance of proving materiality, however, has been eclipsed by House of Lords' inclusion of the requirement of inducement of the actual insurer.²⁹

The Australian courts have thus far declined to follow *Pan Atlantic*'s test of materiality, preferring the more precise test based on the 1974 NSW case of *Mayne Nickless v Pegler*.³⁰ In that case, Justice Samuels held that a fact would be material 'if it would have reasonably affected the mind of the prudent insurer in determining whether he will accept the insurance, and if so, at what premium and on what conditions'. Until the High Court rules on the matter, the exact formulation of the test of materiality for Australian marine insurance — and whether the inducement of the actual insurer is required — is not certain.³¹

For the insured's duty to disclose, there is at least a roadmap (albeit muddy

25 See Merkin, above n 11, at n 84 and text accompanying; citing *Manifest Shipping Co v Uni-Polaris Insurance Co Ltd, the Star Sea* [1995] 1 Lloyd's Rep 651. In relation to post contractual duties, the primary manifestation is in relation to fair claims handling.

26 Readers will note the very careful wording, which is not by way of suggesting a definition but rather seeking to avoid such phrases as 'material' or 'relevant'.

27 [1995] 1 AC 501; [1994] 3 All ER 581; [1994] 3 WLR 677 (HL); [1994] 2 Lloyd's Rep 427.

28 ALRC Report 91, at [10.17].

29 The writer understands from UK practitioners that most cases on non-disclosure now turn on the point of actual inducement rather than the concept of materiality.

30 See S C Derrington (2000) 11 *ILJ* 1 at 8; also N G Rein, 'Utmost Good Faith in Insurance Contracts' (1999) 10 *ILJ* 145 at text accompanying n 58.

31 However, Justices Gummow and Hayne cited the materiality test in *Mayne Nickless* with approval in the High Court case of *Permanent Trustee Australia Ltd v F&I General Insurance Company Ltd* (2003) 214 CLR 514; 197 ALR 364 at 381; [2003] HCA 25 at [67]; BC200302168.

in places) of what the insured must do, and what the insurer is entitled to expect. The roadmap is different for the MIA and the ICA. The MIA requires disclosure of material circumstances, and it will be material if it would influence the judgment of a prudent insurer.³²

However, a roadmap has not yet been written to describe what *insurers* must do to comply, and what insureds can expect from their insurer in marine insurance. The English case law gives us some information. In the *Banque Financiere* litigation discussed further below, the judge at first instance described the duty as requiring disclosure *by the insurer* of:

matters peculiarly within the knowledge of the insurers, which the insurers know that the *insured* is ignorant of and unable to discover but which are material in the sense of being calculated to influence the decision of the insured to conclude the contract of insurance. In considering whether the duty of disclosure is activated in a given case the court ought . . . to test any provisional conclusion by asking the single question: Did good faith and fair dealing require a disclosure?³³

However this test appears to have been abandoned in the United Kingdom in favour of couching it in the same terms as the reciprocal duty on the insured under the MIA; namely, based on materiality to a *prudent* insured in relation to a narrow range of situations. English Court of Appeal, in overruling Steyn J, said ‘broad concepts of honesty and fair dealing, however laudable, are a somewhat uncertain guide’.³⁴ The Court of Appeal sought to reduce the scope of the duty:

The duty falling upon the insurer must at least extend to disclosing all facts known to him which are material either to the *nature of the risk sought to be covered* or the *recoverability of a claim* under the policy which a *prudent insured* would take into account in deciding whether or not to place the risk for which he seeks cover with that insurer.³⁵

Lord Bridge in the House of Lords ‘did not dissent’ from that statement.³⁶ Viewing it even more narrowly by requiring disclosure only of material facts that *reduced* the risk, Lord Jauncey described the insurer’s pre-contractual duty as requiring disclosure of:

facts which are material to the risk insured, that is to say facts that would influence . . . a *prudent insured* in entering into the contract on the terms proposed by the insurer. Thus any facts which would *reduce the risk* should be disclosed by the insurer.³⁷

32 Section 24 of the MIA. The ICA requires disclosure of circumstances the insured knows would be relevant or ought to reasonably know. Section 21 of the ICA.

33 *La Banque Financiere de la Cite SA v Westgate Insurance Co Ltd* [1990] QB 665 at 703 (Steyn J). (Emphasis added).

34 *La Banque Financiere de la Cite SA v Westgate Insurance Co Ltd* [1990] QB 665 at 772 (Slade LJ, delivering judgment of the Court of Appeal); [1987] 2 All ER 923; [1987] 2 WLR 1300; [1987] 1 Lloyd’s Rep 69.

35 *Ibid* (emphasis added).

36 [1990] 2 Lloyd’s Law Reports 377 at 380.

37 *Ibid*, at 389 (emphasis added).

With respect, it is submitted that this is too narrow because it would not require disclosure of a fact imperilling the insured's cover. Further, it is inappropriate to talk of 'reducing the risk' to the insured.³⁸

In Australia there has been at least one case to consider the matter, though it did not explore the exact nature of the insurer's duty.³⁹

Overall the test for the duty of an insurer for pre-contractual disclosure at common law has yet to be defined or fleshed out. It is likely to be a modification of the duty of the insured⁴⁰ (although the current uncertainty with the test of materiality does not help). One would expect the standard of the obligation to be equally rigorous for both insurer and insured, but until cases explore the point in more detail, we have little to go on.

The reason for the dearth of cases considering the nature of the insurer's duty is because the remedy consequent on the breach means that the insured has little incentive to argue that the insurer has breached the duty. It is to the remedy that we now turn.

Focusing on the remedy

As s 23 clearly illustrates, the remedy envisaged for a breach of utmost good faith is avoidance of the contract by the wronged party. This has the effect of rendering the contract as if it had never been on foot, with any premium paid to be returned.

As the MIA was drafted to capture the essence of the common law, it is useful to pay close attention to Lord Mansfield's judgment in the extract from *Carter v Boehm* quoted above. That judgment illustrates the insurer's duty and insured's remedy. Insuring a ship voyage when the insurer knew the vessel had already arrived would naturally mean that the insured had wasted his or her money in taking out a policy; and the refund of premium to the insured consequent on avoidance by the insured is an entirely appropriate remedy in those circumstances. The wording of s 23 reflects Lord Mansfield's judgment.

However, in other situations where the *insurer* may have breached the duty, rescission is not an attractive option for an insured seeking recourse. Rescission means extinguishing a contract that may be the insured's only means of recompense should an insured event occur. Invariably, by the time

³⁸ See Kelly and Ball, below n 40.

³⁹ *Speno Rail Maintenance Australia Pty Ltd v Hamersley Iron Pty Ltd* (2000) 23 WAR 291; (2001) 11 ANZ Ins Cas 61-485; [2000] WASCA 408; BC200007850. Speno was a complex case. One counterclaim involved Speno's claim against the insurer for a breach of utmost good faith when it found that it had not received the waiver against subrogation clause that it had insisted be included in the policy wording. Malcolm CJ found there was a breach, but that Speno was not entitled to a remedy as it had affirmed the contract: at [46]. The majority of the WA Court of Appeal, at [178] per Justice Wheeler, found that this was not a breach of utmost good faith:

The contention made on behalf of Speno must involve the proposition that it is not enough for the insurer, where requested to provide cover in particular terms (which terms may be in some cases detailed and complex) simply to provide as Zurich did the proposed policy wording; rather, it must specifically draw to the attention of the insured every way in which the policy proposed by the insurer may differ from that sought by the insured. I do not see why this should be so.

⁴⁰ See D Kelly and M Ball, *Principles of Insurance Law*, (online, LexisNexis), at 3.0030.1, as to why the duty should not be the flipside of the insured's duty.

that the insured is aware of the insurer's failure to act in utmost good faith, the insured has sustained a loss. What s 23 does not accommodate is the situation where the insured has acted in reliance of the fact that it has insurance in place; for example, by not obtaining cover elsewhere that would have responded to the loss. Lord Mansfield's judgment in *Carter v Boehm* did not deal with such a scenario.

There have been attempts to argue that avoidance is not the exclusive remedy and that, in the right circumstances, perhaps damages might be recoverable. This was based upon the notion that utmost good faith could be characterised as a contractual implied term, or as a tortious duty, either of which would sound in damages. This argument has been explored in several UK cases. In *Banque Financiere de la Cite SA v Westgate Insurance Co Ltd*⁴¹ upon renewal of a policy of credit insurance, the insurer discovered that the insureds' broker had acted dishonestly in the initial period of cover. The insurer did not alert the insureds (a number of banks). Further funds were lent by the banks to their customer, Mr Ballestero, on the strength of the credit insurance. When the funds went missing as a result of a separate act of fraud by Mr Ballestero, the insurers invoked a fraud exclusion clause. The insureds turned to the insurer, alleging that they should have been told of the broker's dishonesty, and had they been told they would not have continued to do business with the broker. If there had been no credit insurance they would not have continued with the transaction. The insured banks alleged (amongst other things)⁴² that they were entitled to damages either because the duty of utmost good faith was an implied term of the contract, or the insurer had breached its common law duty of care. What the insureds wanted, of course, was to be able to recover under the insurance contract, not to rescind it.

Justice Steyn, at first instance, confirmed that the duty of utmost good faith was reciprocal, and that there had been a clear breach of the duty by the insurer.⁴³ His Honour was prepared to hold that damages were recoverable for a breach of the duty of utmost good faith in certain circumstances, such as that before him.

The Court of Appeal reversed the result. The Court of Appeal agreed that the insurer was in breach of its duty of disclosure, and that the fraud of the broker was a material fact which ought to have been disclosed. However, it held that this did not entitle the insured to damages. The breach of utmost good faith was to be characterised as an incident of the insurance contract that only entitled the insured to rescind and reclaim the premium paid. To recover damages, the claim would have to be based on the obligation being an implied

41 [1990] 1 QB 655; [1989] 2 All ER 952; [1989] 3 WLR 25 per Steyn J. This was not a contract of marine insurance, but was common ground that there was no relevant difference between the common law of insurance and the MIA (UK).

42 Amusingly, Steyn J says at *ibid*, [1990] 1 QB 655, 699:

The plaintiffs assert that the defendants were under a legal duty to disclose to them, directly or indirectly, the dishonesty of Mr Lee. This assertion is made in a novel situation. Not surprisingly every remotely relevant rubric of the law has been invoked. The pleadings run to many hundreds of pages and are an enduring tribute to the ingenuity of junior counsel.

43 *Ibid*, at 703.

term of the contract, or negligence.⁴⁴ Those causes of action were not made out.

The House of Lords approved the Court of Appeal judgment but decided the appeal on a matter of causation.⁴⁵ On the facts, the House differed from both the lower courts, finding that the broker's fraud was irrelevant to and did not cause the insured's loss, nor would the broker's fraud have given grounds for the insurer to repudiate liability.⁴⁶ The loss had been caused by the separate fraud of Mr Ballestero, and it was that fraud that entitled the insurers to decline the claim. Therefore it was unnecessary for the House to decide whether any duty of utmost good faith had been breached or whether damages would flow from a breach. However Lord Templeman (with whom Lord Ackner and Lord Brandon agreed) and Lord Jauncey were inclined towards the view that rescission was the only remedy available for breach of utmost good faith.⁴⁷

In *The Star Sea*⁴⁸ the parties accepted that utmost good faith was an incident of insurance law rather than an implied term, and therefore no damages could lie for breach of contract.⁴⁹

In Australia, the issue has arisen in the context of insurers seeking remedy for non-disclosure against insureds in cases that predate or fall outside the ICA. In *Khoury v GIO*, the High Court of Australia rejected the argument that the duty of utmost good faith was an implied term of a contract of insurance:⁵⁰

As a matter of principle, the insured's duty to disclose material facts should be seen not as an implied term of the contract but as an obligation which the common law imposes as an incident of the relationship between the parties to the insurance transaction.⁵¹

The Australian courts have appeared to accept⁵² the basic premise that at common law that the only remedy for breach of utmost good faith is

44 [1990] 1 QB 655 at 776 per Slade LJ; [1989] 2 All ER 952; [1989] 3 WLR 25.

45 *Banque Financiere de la Cite SA v Skandia (UK) Insurance Co Ltd* [1990] 2 Lloyd's Law Reports 377. See Hawke, above n 1, at text accompanying n 47 for a longer but pithy description of the case and its outcome; also the Law Commission, *Damages for late payment and the Insurer's duty of good faith*, Issues Paper 6, at 4.24.

46 *La Banque Financiere de la Cite SA v Skandia (UK) Insurance Co Ltd* [1990] 2 Lloyd's Law Reports 377 at 380 per Lord Bridge.

47 *Ibid.*, at 387 and 388 respectively.

48 *Manifest Shipping Co Ltd v Uni-Polaris Insurance Co Ltd (The Star Sea)* [2003] 1 AC 469; [2001] 1 All ER 743; [2001] 2 WLR 170; [2001] 1 Lloyd's Rep 389.

49 See Court of Appeal decision in *Star Sea* [1997] 1 Lloyd's LR 360 at 369.

50 (1985) 165 CLR 622 at 637; 54 ALR 639 at 648–9; [1984] HCA 55; BC8400510. The case, which predated the ICA, involved s 18 of the Insurance Act 1902 (NSW). That provision allowed the court to excuse a failure of the insured to perform a term or condition of the contract where the insurer was not prejudiced by the failure. Khoury sought to rely on that provision to excuse a failure to comply with the duty of disclosure but the High Court held that the duty was not a 'term or condition of the contract of insurance'.

51 *Ibid.*, at ALR 649.

52 There are decisions both predating the *Banque Keyser* decision (*Khoury v GIO* (1989) 165 CLR 622; 54 ALR 639; [1984] HCA 55; BC8400510) and postdating it (albeit obiter): eg, Kirby J in *CGU v AMP* (2007) 235 CLR 1; 237 ALR 420; [2007] HCA 36; BC200707214 at [126]. On a related point, Justice Badgery-Parker did excite interest when he refused to strike out an allegation that employees and workers compensation insurers owed each other a duty of good faith the breach of which founds a tortious action for damages: *Gibson v Parkes District Hospital* (1991) 26 NSWLR 9; (1991) Aust Torts Reports 81–140.

avoidance.⁵³ In Australia, there appears to have been no case where an insured seeks damages at common law for a pre-contractual breach of utmost good faith.⁵⁴

The effect of this limited and (from the point of view of the insured) inadequate remedy is that in Australia at least, there has been 'no reported case at common law where the duty of utmost good faith operated to the benefit of the insured'.⁵⁵

This article began with a quotation from Fred Hawke as to a possible pre-contractual breach of utmost good faith by an insurer. Much is made of the fact that Lord Mansfield talked only of avoidance, but one can only hazard at Lord Mansfield's response had such a scenario come before him. Perhaps his Lordship might have carved out an exception or a different construction that would allow the contract to remain on foot to the benefit of the insured. Although the Act stipulates only the remedy of avoidance, but it was designed only to capture the law as it stood at that time. The MIA was not intended to be a complete code⁵⁶ and the courts have not always resisted the temptation to alter its provisions to achieve a just result.⁵⁷

Regardless of the current state of legal perambulations that render it otherwise, it is clearly accepted by law reform bodies in both Australia and England that it is just to hold the insurer to the bargain (providing cover against a risk) when it is the party that has breached its duty of good faith. Justice Steyn, in the *Banque Financiere* litigation, thought as much:

The question whether an action of damages lies for breach of the obligation of the utmost good faith in an insurance context must be considered from the point of view of legal principle and policy. Once it is accepted that the principle of utmost good faith imposes meaningful reciprocal duties, owed by the insured to the insurers and vice versa, it seems anomalous that there should be no claim for damages for breach of those duties in a case where that is the only effective remedy [on the facts of the case] . . . an order for return of the premiums . . . is a derisory remedy in relation to the true loss . . .⁵⁸

However the judge was inclined toward a tortious duty, rather than one based on contract. (see P J Handford, (1993) *Tort L Rev* 87 at 89). This case was resolved without court intervention: *CGU Workers Compensation (NSW) Ltd v Garcia* (2007) 69 NSWLR 680; (2007) Aust Torts Reports 81–908 [2007] NSWCA 193; BC200706429 at [102].

53 Commentators, however, have been less convinced: See, eg, Kelly and Ball, above n 40.

54 This article leaves to one side the debate about whether the common law *post* contractual duty of utmost good faith should be differently characterised to the *pre* contractual duty: see Rein, above n 30, discussion at text accompanying n 31. For an excellent discussion of pre-contractual disclosure see Kelly and Ball, above n 39, at [3.0020]–[3.0060].

55 Kirby in *CGU v AMP* (2007) 235 CLR 1; 237 ALR 420; [2007] HCA 36; BC200707214 at [126].

56 See s 4.

57 The *Pan Atlantic* litigation is a case in point. The courts effectively added a new element to the statutory test for materiality, by requiring that not only the prudent insurer would have found the fact material, but also the actual insurer 'without the misrepresentation, the insurer would not have entered into the policy, either at all or on the same terms': Law Commission report, *Consumer Insurance Law: pre-contract disclosure and misrepresentation* (December 2009), at [6.7].

58 See [1990] 1 QB 655 at p 704–5; [1989] 2 All ER 952; [1989] 3 WLR 25.

However, as it currently stands, the remedy is a 'one way street'.⁵⁹

Reform

Australia — ICA

The ICA, reforming the law of general insurance in 1986, contained a provision that significantly improved the prospect of meaningful remedies for the insured for breach of pre-contractual utmost good faith. These provisions, which will be discussed in greater depth in another paper in this issue, state:

13 The duty of the utmost good faith

A contract of insurance is a contract based on the utmost good faith and there is *implied in such a contract* a provision requiring each party to it to act towards the other party, in respect of any matter arising under or in relation to it, with the utmost good faith.⁶⁰

14 Parties not to rely on provisions except in the utmost good faith

(1) If reliance by a party to a contract of insurance on a provision of the contract would be to fail to act with the utmost good faith, the party may not rely on the provision. . . .

In short, the duty is now implied as a contractual term and therefore damages can be awarded for breach of that term. However, there is a narrow and a broad view about whether a pre-contractual breach can lead to damages under s 13. The narrow view holds that it cannot, because that would require reliance on a contract that did not exist at the time of the breach. The wide view takes a more purposive approach, arguing that the intent is to provide a proper remedy where one did not exist before. As yet there appears to be no case decided on the issue.

The ICA also alters the test of non-disclosure for an insured so that the relevance of a fact to be disclosed to an insurer is adjudged from the insured's point of view (both subjective and objective), rather than the insurer's.

ALRC proposal for reform of utmost good faith in marine insurance

The ALRC Report 91, released in 2001, outlined the remedy at general law for the breach of the duty of disclosure.⁶¹ It envisaged the remedy as being one either the insured or the insurer may need to access.⁶² The report made it clear that rescission is:

⁵⁹ Kirby in *CGU Insurance Ltd v AMP Financial Planning Pty Ltd* (2007) 235 CLR 1; 237 ALR 420; [2007] HCA 36; BC200707214 at [127].

⁶⁰ However, the inherent contradiction in s 13 is that it implied a term of a contract that required compliance before there even was a contract.

⁶¹ ALRC Report 91, at 10.101.

⁶² 'Reform of the law concerning disclosure could introduce more flexible remedies appropriate to the measure of fault of the party in breach': *ibid*, at 10.100.

not likely to be a practical remedy for an insured who has suffered loss because of non disclosure or misrepresentation on the part of the insurer . . . breach of the duty does not sound in damages, which are generally available only if a contractual or tortious obligation has been breached.⁶³

The report then goes on to outline and recommend a replacement schema for remedies for nondisclosure by the insured.⁶⁴ While that emphasis is to be expected, it is curious that no further express mention of the remedy available for the *insured* for a pre-contractual breach of duty of utmost good faith *by the insurer* is forthcoming in the report.

The proposed amendments to s 23 of the MIA involved deleting the current section and replacing it with much the same provisions as exist in ss 13 and 14 of ICA:

- (1) A contract of marine insurance is a contract based on utmost good faith and there is implied in such a contract a provision requiring each party to it to act towards the other party, in respect of any matter arising under or in relation to it, with the utmost good faith.
- (2) If reliance by a party to a contract of marine insurance on a provision of the contract would be to fail to act with the utmost good faith, the party may not rely on the provision.
- ...
- (4) In deciding whether reliance by an insurer on a provision of a contract of marine insurance would be to fail to act with the utmost good faith, the court shall have regard to any notification of the provision that was given to the assured, whether a notification of a kind mentioned in this Act or otherwise.
- (5) The requirement that each party act towards the other party with the utmost good faith extends for the duration of the relationship between the parties set out in the contract of marine insurance. . . .

Were this to be adopted, would the revised s 23 allow an insured some more meaningful remedy than the current position? The answer would have to be yes. The proposed revised s 23 would assist an insured where the insurer fails to disclose a relevant or material circumstance⁶⁵ prior to entering a contract. First of all, it makes utmost good faith a term of the contract; it has been accepted under the ICA that this provision means a breach of utmost good faith can sound in damages.⁶⁶ Alternatively, the proposed s 23(2) would allow an insured to take issue with the insurer's entitlement to rely on a particular provision by alleging that doing so is a breach of utmost good faith. If the court ruled that the insurer could not in fact rely on that term, then the insured is one step closer to recovery under the policy.⁶⁷

The ALRC Report 20 on Insurance Contracts, which led to the ICA, suggested that damages for a breach of the duty of good faith by the insurer

⁶³ Ibid, at 10.101.

⁶⁴ Ibid, at 10-102-10.120.

⁶⁵ See discussion above at text accompanying n 26 onwards about different tests of disclosure under MIA and ICA.

⁶⁶ There is still the issue that, at the time the duty has been breached, there was no contract on foot; but inducement to enter the contract might be relevant.

⁶⁷ As regards the test of materiality, that remains mainly untouched, although the ALRC suggested the standard of disclosure be based what a reasonable person in the insured's position would know to be material. Report 91, App B (proposed amended MIA), s 24(1).

should be based on ordinary contractual principles.⁶⁸ Therefore, as noted by Fred Hawke,⁶⁹ had *Banque Financiere* occurred under an ICA regime, the insured would still not have recovered because of an inability to show a causal link between the breach and the cause of the loss. It is important that the insured's right to claim should be fairly and carefully constrained.

As already noted, the ALRC Report 91, with its recommendation to reform s 23 regarding utmost good faith has not found governmental support. Recently, Professor Merkin has revived talk of reform to the MIA. Were either the ALRC report to be re-examined, or were Australia to adopt Professor Merkin's proposal⁷⁰ the insured would undoubtedly be better off than it is currently in relation to its ability to claim a real remedy for the insurer's breach of pre-contractual utmost good faith.

This raises a related point. The dearth of cases on an *insurer's* pre-contractual duty of utmost good faith means that the exact content of that duty will fall to be determined through case law.⁷¹ As we have seen, there is no formulation for pre-contractual duty of disclosure for insurers, but courts have been known to extrapolate the duty by analogy with the insured's statutory duty of non-disclosure.⁷² If the ICA model for utmost good faith was adopted, legal advisors would have to be a little circumspect in relying upon the case law and academic writings about the ICA regarding pre-contractual disclosure. This is because the test for and scope of the duty of disclosure under the MIA (materiality) is different to that under the ICA (relevance).⁷³ Once the insured is provided with a proper remedy for the insurer's pre-contractual breach of utmost good faith, the courts will have to shape the elements of the cause of action itself.

England

It is fair to say that the position in the United Kingdom is in a state of flux. Initial discussions of reform appeared to favour some sort of generalised reform of the remedy for breach of utmost good faith, but more recent indications are that the reform may only be for post contractual breaches.

In the UK, the Law Commission and Scottish Law Commission (the Law Commissions) have been considering the whole gamut of insurance law in their detailed reform proposals. More recently, as we shall see, they have considered utmost good faith, particularly in relation to insurer's duties. There

68 ALRC report, *Insurance Contracts*, p 328. While this was discussed in the part of the report dealing with claims handling, the report says 'legislation should make it clear that the duty of good faith applies to all aspects of the relationship between insurer and insured, *including* the settlement of claims' (emphasis added).

69 Above n 1, at text accompanying n 54.

70 That the MIA be abandoned and marine insurance folded into the ICA.

71 Currently, as the Law Commission and the Scottish Law Commission note, there is little case law on the insurer's duty and rather more on the insureds: *Damages for Late Payment and the Insurer's Duty of Good Faith*, Issues Paper 6 (March 2010) summary, at [18].

72 See House of Lords in *Banque Financiere* [1990] 1 QB 655; [1989] 2 All ER 952; [1989] 3 WLR 25.

73 See discussion above at text accompanying n 26 onwards. Also see *Permanent Trustee Australia Ltd v FAI General Insurance Company Ltd* (2003) 214 CLR 514; 197 ALR 364; [2003] HCA 25; BC200302168 per McHugh, Kirby and Callinan JJ. Of course, it is possible and indeed desirable for the insured's duty of disclosure to be reformed at the same time.

has been an understandable preoccupation with reforming the law of remedies for late payment of claims,⁷⁴ and much of the discussion of good faith has been in this context.

Their initial issues paper titled *Damages for late payment and insurer's duty of good faith*⁷⁵ (UK reform Mark I) showed the United Kingdom taking a slightly different approach to reform of utmost good faith to that of Australia. The initial preference was not to create an implied term, nor a tortious duty. Instead, the proposal was to leave the duty as a separate incident of the insurance contract, but reversing the effect of the *Banque Financiere* decision by creating statutory remedies for the failure to act in good faith:⁷⁶

The insurer should be liable to compensate the insured for actual loss resulting from the breach, providing such loss was foreseeable at the time the contract was made.⁷⁷

This would have the benefit of being more conceptually elegant than the Australian solution⁷⁸ but in the end, likely to achieve the same result.⁷⁹ While this was couched in discussion of late payment of claims, other comments in the issues paper suggested that the reform proposed was to provide a general remedy for breach of utmost good faith by an insurer.⁸⁰

The Law Commissions invited submissions pending a further consultation paper. That consultation paper was released in December 2011: *Insurance Contract Law — Post Contract Duties and other issues*.⁸¹ The consultation paper shows an interesting shift in emphasis (UK reform Mark II). The proposed reworking of the remedy for breach of good faith by the insurer is now to be confined to late payment.⁸² The notion of giving a generalised remedy of damages for breach of the duty by an insurer has fallen out of

74 And the effect of the decision in *Sprung v Royal Insurance (UK) Ltd* [1999] 1 Lloyd's Rep IR 111; [1997] CLC 70. See n 81 below at [2.15].

75 Law Commission and Scottish Law Commission Issues Paper No. 6, March 2010,

76 Ibid, at [4.53].

77 Ibid, at [4.54]. The main focus of the issues paper was the quality of the insurer's post contractual duty of utmost good faith, but the introductory discussions make it clear that utmost good faith in general is being discussed: see [4.23]; [4.3]. One explanation may be that the courts had clearly accepted a duty of disclosure on the insurer prior to entering the contract, while the imposition of a post contractual duty on the insurer remained controversial.

78 Because it resolves the difficulty of a contract term being 'breached' before the contract is entered.

79 It is also worth noting that the common law regarding non-disclosure is in the process of being reformed, such that the MIA provisions will no longer be viewed as codifying the law applicable to general insurance contracts. Marine insurance will remain subject to the provisions of the MIA (UK) at least in relation to commercial (non consumer) policies. See Law Commissions' report, *Consumer Insurance Law: Pre-contract disclosure and misrepresentation*, December 2009, at [5.32], [9.3]–[9.18].

80 Above n 75 at [4.3].

81 Law Commission Consultation Paper No 210 and Scottish Law Commission Discussion Paper no 152, *Insurance Contract law: Post Contract Duties and other issues*, 20 December 2011.

82 Ibid, Pt 4. Although note that under the current position in the United Kingdom, poor claims handling can in certain circumstances entitle the insured to payments if one complains to the Financial Ombudsman Service (FOS). See n 75 above, at Part 6.

favour due to concerns that such a doctrine would develop along the lines of the doctrine in the United States:⁸³

we think good faith is best thought of as a shield not a sword. We are minded to keep the duty of good faith as a general interpretative principle, which can be used to prevent either party from using their rights in bad faith, but it would not, in itself, give rise to any specific cause of action.⁸⁴

With respect, this appears to be a retrograde step. It risks leaving an insured without a remedy for lack of good faith unless it can be pigeonholed into a particular category (late payment of claims) or framed as an estoppel based argument. Notably, for our purposes, damages for pre-contractual breach by the insurer appears to have slipped away (at least for business users who do not have a right of recourse to the Financial Ombudsman Service).⁸⁵ This seems odd, not least because the *Banque Financiere* decision was one of pre-contractual non-disclosure and is much discussed throughout the Law Commissions Reports. It is not hard to envisage (as the opening quote from Fred Hawke does) a situation where the insured would be seriously disadvantaged by such conduct by an insurer.

It is submitted that a more generalised duty, complete with a statutory remedy for those rare cases of pre-contractual breach by an insurer, is more desirable than the reforms now being considered under UK reform Mark II. There would be sufficient constraints on the remedy envisaged by the Issues paper to protect insurers from spurious claims,⁸⁶ and it could be made clear that a US style tort of bad faith was not created by the reform.⁸⁷

The Law Commissions will engage in consultations until March 2012 and aim to produce final recommendations for Parliament in 2013.

Conclusion

Under the current MIA, the Australian courts are unlikely to hold that there is an implied term or duty sounding in damages, at least for the time being.⁸⁸ While there has been little case law on the point to date, legal creativity may lead to the insured raising allegations of estoppel,⁸⁹ misleading and deceptive conduct, or unconscionable conduct.⁹⁰ However, these have inherent limitations and uncertainties. For example, the obligation not to mislead or

⁸³ Above n 81, at 3.16.

⁸⁴ See *ibid*, at 1.40.

⁸⁵ Consumers and small business are entitled to take complaints about insurers to the Financial Ombudsman Service (FOS). The FOS has power to award up to £150,000, and is not bound by rules of law. Many of its decisions are based on inadequate product disclosure by insurers and it is acknowledged by the FOS that they regularly ignore the law in the United Kingdom which would prevent damages for late payment of claims: above n 75, at 3.28.

⁸⁶ Namely, requiring that before an insured could claim for breach of good faith from the insurer, the insured had to show a valid claim, causation, and that the insurer would only be liable for actual losses that were foreseeable: Issues paper 6, at 9.26.

⁸⁷ It could be made clear in the legislation or explanatory memorandum that the remedy was not a tort of bad faith in the US style.

⁸⁸ The High Court would need to rule definitively on this for the situation to be certain: see Rein, above n 30, text accompanying n 50.

⁸⁹ Estoppel was raised by AMP in the case of *CGU v AMP*.

⁹⁰ See, generally, S Drummond, 'Unconscionable conduct and utmost good faith' (2003) 14 *ILJ* 208 and particularly at text accompanying n 44 where he points out the broader range

deceive is not as onerous as the duty of utmost good faith,⁹¹ and therefore (even if applicable) it may not be of much assistance. It is advisable to keep the remedies of an insured contained within the ambit of insurance law. That way, insurance law can develop in a measured and coherent fashion, and litigation can avoid a multiplicity of causes of action and unfamiliar intersections between them may lead to unexpected results.⁹²

The movement toward reform of the MIA parent Act in the United Kingdom should provide Australia with impetus to consider reform of its MIA. One would hazard a guess that the Australian market, used to the ICA reforms, would adapt readily to the ICA model or something like it,⁹³ and this would be preferable to the UK reform Mark II. In the view of this writer, there is no question that the remedies for a breach of pre-contractual utmost good faith by the insurer should be rewritten so as to provide true recourse for the insured in deserving cases.⁹⁴

of remedies available for unconscionable conduct. He particularly notes that it will assist an insured pressing for payment of a claim under a policy at common law, where rescission is the only remedy.

91 For example, need not inform the insured of something that might be of assistance or it might desire to know: *Miller & Associates Insurance Broking Pty Ltd v BMW Australia Finance Ltd* (2010) 241 CLR 357; 270 ALR 204; [2010] HCA 31; BC201007172.

92 See Hawke, above n 1, at text accompanying n 12.

93 The provision could be made clearer by specifically providing for a remedy for pre-contractual utmost good faith; the ICA formulation leaves at least an argument that good faith remedies only apply for post contractual breaches and the statutory duty only applies once the contract is in place. See CCH Commentary, at 16–650.

94 ALRC Report 91, at 10.150.